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Mr. Melvin F. Clemens, Jr.
Director of the Office of Compliance and Enforcement
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423-0001

Dear Mr. Clemens:

This is in response to Chairman Nober's letter concerning "Fall Peak Service Demands."

I. Overview

Traffic volumes have been strong throughout 2004 and we expect more of the same during the Fall Peak. We expect to handle these strong, perhaps record, volumes much as we have handled the high volumes throughout the year – safely and efficiently. The planning necessary to accomplish this is the type of planning we do throughout the year. Over the last several years we have increased our purchases of locomotives and hiring of new train crews in anticipation of the economic recovery. This has enabled us to better handle these new and higher volumes. Having said that, we know that the volumes projected for the Fall Peak, as well as the current outlook for demand for rail services well beyond the Fall Peak, are unprecedented. We recognize that the challenges we may face once we begin to see the actual volumes shippers are asking us to handle during the Fall Peak may be even greater than we have anticipated.

II. Traffic Expectations for the Fall Peak

While intermodal volume levels are expected to be very strong, it is also worth noting that the Fall Peak is not as pronounced as it used to be. International business, whether moving intact in a marine container to inland points or being transloaded into a domestic container, is a large driver of the intermodal business. Ships from Asia and Europe have been running close to 100% capacity since March, but we expect some additional capacity to come on line in the coming months. Large importers, aware of ship constraints and other possible problems in the supply chain (such as the West Coast port strike in 2002) are importing freight into the U.S. earlier and earlier, thus smoothing out the peak. Some large retailers have had imported Christmas goods in warehouses since March.

Coal volumes should be strong as well, reflecting both a strong demand for coal and the fact that stockpiles are lower than they have traditionally been. Some utilities have elected to reduce stockpiles in order to lower inventory costs. Some stockpiles are lower because there have been production problems in the Central Appalachian and Northern Appalachian mines. Some stockpiles are lower because coal that would have been destined for utility consumption has instead been diverted to the export market because in recent months the price for coal in that market has been higher than in the utility market. The combination of these factors creates a real challenge to all parties in the coal supply chain.

At Norfolk Southern, Merchandise is the third major marketing group and includes everything other than Coal and Intermodal. The major commodity groups within Merchandise are (i) Agriculture, Fertilizer and Consumer, (ii) Automotive, (iii) Chemicals, (iv) Metals and (v) Paper, Clay and Forest. We anticipate continued strong demand in our Merchandise business.

III. Operational Planning

The TOP (Thoroughbred Operating Plan) is the responsibility of the TOP Steering Committee, a group of senior managers from Operations, Marketing, Information Technology, Strategic Planning and Finance. As previously stated, as a matter of routine we make periodic changes to the plan due to changes in business. We are accustomed to anticipating more volume in the fall, and as a result we tend to make somewhat more changes to the plan for the Fall Peak than for other times of year.

This summer, based on the latest forecasts from Marketing, changes will be made to the operating plan. These revisions will enable us to further fill out existing trains as well as establish any new additional trains. We anticipate that additional (scheduled) trains will in many cases take the place of extra trains we are currently operating on an as-needed basis. A primary tool we use is our Operating Plan Developer (OPD), a computer model that determines how many trains will need to be added, and at what locations. OPD output will also form the basis of our analysis to balance the locomotive plan and crew plans with any additional train requirements.

In August 2004 NS will re-open Sevier Yard in Knoxville, Tennessee as a major classification terminal. The humping operation at Sevier Yard will add additional capacity to the NS Network allowing for increasing volumes from the western gateways, Kansas City and St. Louis, to the Southeast via Knoxville.

In anticipation of increasing business levels, we have brought on more locomotive power this year than has been done historically. Through the Peak Season we will be leasing between 80-95 locomotives (as opposed to 55-60 today). We will have taken delivery of 90 new locomotives in 2004 by the end of July and will receive another 117 new locomotives during the 4th quarter, beginning in October. This includes 92, 2005 locomotive purchases which were advanced to the 4th quarter of 2004. Our 2004 locomotive retirement plan has been reduced to keep the number of units in service in line with expected needs, and we have ramped up the locomotive overhaul program this year. While we are ramping up our locomotive supply, we will likely see our fleet stretched in order to handle anticipated business volumes. We will utilize our fleet to keep our scheduled network running and prioritize our unit train operations.

With respect to crews, Norfolk Southern has not experienced crew shortages (except occasional holiday-related spot shortages) at any time during the recent economic recovery. We review our crewing needs on a monthly basis using computer-modeling techniques. In 2003, NS hired 1,329 conductor trainees and trained 156 locomotive engineers. For 2004, we expect to hire 1,333 conductor trainees and to train 330 locomotive engineers. We don't anticipate that crew shortages will be disruptive to service, although we may experience temporary crew shortage issues on some holidays/special occasion weekends.

With increasing demand, car shortages have and will continue to be an issue in several commodity areas. To help address increased demand for rail equipment we have taken a number of steps to increase the number of railcars available to our customers. We have enhanced our car repair efforts--our current schedule of 12,300 scheduled car repairs in 2004 represents a 14% increase over 2003 repairs. We have renewed all expiring equipment leases, with the exception of 81 articulated bi-levels (due to additions in the bi-level fleet), representing 2,429 cars. We have added cars to our fleet: 250 60-ft, Plate F Boxcars, 75 Pressure Differential Hoppers, 400 Covered Coil Cars and 300 Bi-levels. (The boxcar, pressure differential hoppers and bi-levels are new builds; the bi-levels are being acquired directly; the others are being leased.) We have seen improvements in our fleet utilization as a result of the planning and monitoring of the network by the TOP Steering Committee and the overall increase in network velocity that has resulted. In addition, we have established 20 independent car-prepping contractors at strategic locations to address car quality issues prior to car placement. This effort has reduced the number of rejected cars and unproductive car days to reposition cars for cleaning and prepping.

With respect to our performance, we will judge our performance by a number of factors. We will look first at the safety of our operations. We will look at the metrics we make available to the public such as cars on line, terminal dwell and train velocity. We will constantly review the on-time performance of our customer service. We will listen to what our customers have to say about our service. And of course we will balance the costs we incur with the revenues earned.

IV. Communications

Communications with customers will be through normal methods -- email advisories, phone conversations and in person, including at sessions sponsored by the railroads or shippers. As we expect the increase in traffic volumes to be moderate and our service levels to be sustained, we believe the frequency of our communications will not increase significantly.

V. Beyond the Fall Peak

While we expect to be in a position to handle the demand for our rail services during the 2004 Fall Peak, whether supply can be increased to meet the growing demand for rail transportation in the future must be a concern. NS has not earned its cost of capital for a number of years and when NS or any company fails to earn its cost of capital, reinvestments in the company are more limited than they would be otherwise. If demand continues to grow at this pace, the rail industry will need to invest substantially more--in locomotives, IT systems, yards and terminals, railcars, track, etc.--than it is doing today. However, increased investment in additional capacity cannot always be justified economically in the current cost of capital environment. Therefore, if demand continues to grow without the industry earning enough to sustain its capital requirements for growth, it may have little choice but to ration capacity in the future.

We don't like to pay more for the goods and services we purchase, so it comes as no surprise to us that our customers do not want to pay more for our rail services. But demand continues to increase and we are beginning to be challenged as we seek to accommodate the amount of traffic that customers want us to move using our existing infrastructure. We probably enjoy more breathing room than some if not all of the other major U.S. carriers, but it remains obvious to all, including investors, financial institutions and rail management--the returns the industry currently earns will not allow it to reinvest enough to meet the demand for rail services that the future appears to hold.

Sincerely,

David R. Goode